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April 1, 2008

VIA ELECTRONIC AND OVERNIGHT MAIL

Honesto Gatchalian
Energy Division
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Re: Draft Resolution E-4160

Dear Mr. Gatchalian:

In accordance with Rule 14.5 of the Rules of Practice and Procedure of the California Public Utilities Commission (the "Commission") and the instructions accompanying draft Resolution E-4160 (the "Draft Resolution"), San Diego Gas & Electric Company ("SDG&E") submits these comments concerning the Draft Resolution, which seeks to implement Senate Bill ("SB") 1036.

SB 1036 modifies administration of the Renewable Portfolio Standard ("RPS") program by eliminating the responsibility of the California Energy Commission (the "CEC") to award supplemental energy payments ("SEPs") to cover the costs of renewable energy procurement that are above the relevant market price referent ("MPR"). It requires the CEC to transfer all unencumbered funds in the New Renewable Resources Account (the "NRRA") back to the respective utilities for refund to ratepayers and requires a corresponding adjustment in the public goods charge ("PGC") to reflect suspension of collection of the renewable energy portion of the PGC. The provision establishes a virtual bank comprised of "above-MPR funds" ("AMFs") intended to cover the above-MPR costs of renewable energy procurement and directs the Commission to establish the total amount of AMF funds available to each utility.

The Draft Resolution proposes the following actions in order to implement SB 1036:

1) Directs the investor-owned utilities ("IOUs") to adjust their respective public purpose program ("PPP") rate components collecting the PGC;

2) Directs the IOUs to amortize funds transferred from the NRRA in their PPP rate component;

3) Directs Bear Valley Electric Services ("BVES") to establish an account to record unencumbered renewable funds transferred from the CEC back to BVES;

4) Establishes the total amount of AMF funds available to each utility for the procurement of eligible renewable energy resources;

5) Outlines the methodology for an AMF Calculator for the calculation of AMFs requests and the tracking of approved AMFs requests;

6) Sets forth eligibility criteria for power purchase agreement ("PPA") costs that may be applied to the cost limitation;

7) Sets forth reasonableness standards for reviewing above-MPR contract costs; and

8) Sets forth administration rules for the AMFs.

In a letter to Executive Director, Paul Clanon, filed jointly with several other parties, SDG&E requested that the Commission bifurcate implementation of SB 1036 by first approving the proposals related to Issues 1 through 3 above and then addressing Issues 4 through 8.[1/] This bifurcation request was granted, with the caveat that Issue 4 might be considered along with Issues 1-3, rather than with Issues 5-8.[2/]

As is discussed below, SDG&E supports the proposals set forth in the Draft Resolution concerning Issues 1 through 3 and urges the Commission to adopt them. In addition, it has no objection to adoption in the Draft Resolution of the relevant AMF cap for each utility, although it notes that the AMF calculator attached to the Draft Resolution contained PG&E test data in the model and the incorrect weighted cost of capital. The appropriate weighted cost of capital for SDG&E must be used in order to derive SDG&E's AMF amount.

In response to the Commission's directive,[3/] SDG&E also describes below several problematic aspects of the proposals regarding administration of AMFs and reasonableness standards applicable to above-MPR PPAs, but notes that in doing so herein, it does not intend to waive or in any way diminish its right to raise additional and/or different concerns in the context of any future proceedings regarding these issues.

1/ *See* Letter to Paul Clanon from William V. Walsh, dated March 28, 2008.
2/ *See* Letter to William V. Walsh from Paul Clanon, dated March 28, 2008.
3/ *See id*.

A. SB 1036 Ratemaking Proposals Should be Approved

SDG&E supports immediate adoption of the proposals set forth in Section 3.1 of the Draft Resolution. Because the effective date of the required funding adjustment was January 1, 2008, the public interest supports implementation of ratemaking changes at the earliest possible date.[4/] Eliminating the over-collection of renewables funds and refunding amount collected in 2008 will clearly benefit utility ratepayers. While the more complex policy issues associated with implementation of SB 1036 may require additional time and attention, the ratemaking adjustments proposed in Section 3.1 (*i.e.*, Issues 1 through 3 above) are relatively straightforward and should be adopted without further delay.

B. Other SB 1036 Implementation Proposals are Seriously Flawed

While the Draft Resolution purports to implement the requirements of SB 1036, it goes far beyond what is contemplated in that statute. The Draft Resolution proposes adoption of a two-tiered reasonableness review standard for AMF requests. SB 1036, however, contains no language supporting augmentation of the existing review and approval process with an entirely new framework. Indeed, SB 1036 sets forth only five pre-conditions for counting above-MPR costs of a PPA against the AMF cost limitation. These include:

> (A) The contract has been approved by the commission and was selected through a competitive solicitation *pursuant to the requirements of subdivision (d) of Section 399.14*.
>
> (B) The contract covers a duration of no less than 10 years.
>
> (C) The contracted project is a new or repowered facility commencing commercial operations on or after January 1, 2005.
>
> (D) No purchases of renewable energy credits may be eligible for consideration as an above-market cost.
>
> (E) The above-market costs of a contract do not include any indirect expenses including imbalance energy charges, sale of excess energy, decreased generation from existing resources, or transmission upgrades.[5/]

[4/] SDG&E filed Advice Letter 1976-E on March 27, 2008, to establish funding levels for 2008. The 2008 funding levels included an adjustment in accordance with SB 1036.

[5/] Senate Bill (SB) 1036, Sec. 13, § 399.15(d)(2) (Stats. 2007, Ch. 685) (emphasis added).

It is clear from the plain language of SB 1036 that the review and approval process adopted pursuant to P.U. Code § 399.14 and currently applied to all RPS contracts is sufficient and that no additional review framework is either authorized or required. Indeed, the legislative history of the bill specifically discusses the expectation that "[t]he PUC would use *current practices it has in place* to review renewable contracts for reasonableness, and to make sure the specific contracts are written so they are the least costs and best fit for the IOU's needs."[6/] Thus, SB 1036 neither compels nor provides support for adoption of the additional review criteria proposed in the Draft Resolution.

Moreover, it is not at all clear what purpose would be served by the additional review/approval processes outlined in the Draft Resolution. The Commission and stakeholders have expended significant time and effort developing and refining the current review standards, which have been deemed adequate to protect ratepayers. No concerns regarding the efficacy of the current review processes were raised in the Draft Resolution to support the need for additional review criteria in the context of above-MPR costs. It is worth noting that prior to adoption of SB 1036, when the Commission considered above-MPR PPAs it did not require that Advice Letters seeking approval of such PPAs include an additional set of review criteria.[7/] Rather, the Commission's review of above-MPR PPAs was based upon the existing RPS review criteria.

Under the current least-cost, best fit process, the costs proposed to be recovered through rates are taken into account in determining whether the contract as a whole is in the best interest of ratepayers. The Commission has established a presumption that any offer that wins a competitive solicitation is priced at market and thus reasonable, regardless of its cost relative to the MPR. Therefore no further examination of the reasonableness of above-MPR costs, for the purpose of AMF calculation, is warranted. Imposition of an additional layer of review will merely add complication to an already byzantine approval process. Certainly, the question of whether it is reasonable to recover proposed procurement costs in rates is an important one, but it is important for *all* contracts, not just for above-MPR contracts. The current review criteria are intended to permit this determination and if a contract is deemed under the current review criteria to be in the public interest and rate recovery is supported, this should be sufficient. A separate standard of review is not necessary for above-MPR contracts.

In addition to its skepticism regarding the need for the additional review criteria outlined in the Draft Resolution, SDG&E notes a number of major flaws in the Commission's proposal. First, the Draft Resolution is confusing in certain material respects. It is unclear, for example, whether the Commission views the AMF limit as an absolute cap on above-MPR expenditures, or whether IOUs would still be permitted to seek approval and rate recovery for above-MPR PPAs even where the AMF cap had been reached. The uncertainty arises because the Draft Resolution refers to the establishment of a "*total* cost limitation for above-MPR costs each utility

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6/ Analysis of SB 1036 by the Assembly Committee on Utilities and Commerce, June 29, 2007, page D (emphasis added). Available at: http://info.sen.ca.gov/pub/07-08/bill/sen/sb_1001-1050/sb_1036_cfa_20070629_131705_asm_comm.html

7/ *See e.g.* SDG&E Advice Letter 1795-E (Esmeralda Truckhaven Geothermal, LLC).

can expend on the procurement of eligible renewable energy resources,"[8/] which suggests an absolute cap on above-MPR procurement, but elsewhere discusses the ability of the IOUs to voluntarily procure renewable energy at above-MPR prices and to seek cost recovery for such procurement without counting the above-MPR expenditures toward the AMF cap.[9/] SDG&E believes that SB 1036 intends the latter option to be available to the IOUs and it has committed to a policy of continuing to procure reasonably-priced renewable energy even after AMFs have been exhausted, but the operation of the cap will clearly impact its ability to do so. Thus, greater clarity on this point is required. Similarly, the Draft Resolution is ambiguous as to whether it is possible that an above-MPR PPA could be approved for rate recovery, but not deemed eligible for AMFs. This, too, must be clarified.

In addition, the Draft Resolution appears to run counter to the goals of SB 1036. The legislation was intended to simplify the process for obtaining funds to cover above-MPR procurement costs and to provide greater certainty to developers seeking to access the financial market.[10/] Adoption of the additional approval processes will have the opposite effect, however, injecting significant regulatory uncertainty into the RPS program at a time when the IOUs can ill afford any chilling of the renewables market. As the credit squeeze tightens, concerns over unreasonable approval standards and the possibility discussed in the Draft Resolution that the Commission might approve only a *partial* allocation of contract costs toward the AMF cost limitation or might reduce or terminate the AMFs dedicated to a project will significantly undermine developers' ability to obtain the financing necessary to fund renewables projects.[11/]

SDG&E is also concerned that certain of the proposed criteria are arbitrary and are not supported by either statutory authority or common sense. The rationale underlying creation of two separate review tiers, for example, is not provided and the $5,000,000 demarcation point between the tiers appears to have been plucked from thin air. Likewise, the 18-month window for submission of above-MPR PPAs makes little sense. As SDG&E has explained previously, the complex nature of contract negotiations makes it impractical to establish a one-size-fits-all time period for negotiation. The Draft Resolution fails to explain how the public interest is served by elimination of an otherwise favorable PPA simply because the negotiation process is not concluded within this set timeframe, or why 18 months was the period chosen. Given the imminence of the 2010 RPS compliance deadline, the Commission should be considering all available means of improving the IOUs' ability to sign RPS PPAs, not manufacturing artificial obstacles that will hinder their efforts to do so.

8/ Draft Resolution at p. 6 (emphasis added).
9/ *Id*. at p. 22.
10/ *See* Analysis of SB 1036 by the Assembly Committee on Utilities and Commerce, *supra*, note 6.
11/ *See* Draft Resolution at pp. 19, 22-23.

Certain other proposed review criteria are so vague and subjective that it will be virtually impossible for parties to achieve any degree of certainty concerning whether a given above-MPR PPA is likely to obtain Commission approval. The question of whether a projected COD is "realistic," for example, is a judgment call; it is not capable of being definitively proven or disproven.[12/] Moreover, adoption of an explicit requirement that the above-MPR PPA contain a "realistic" commercial online date ("COD") is unnecessary. Certainly all parties understand the importance of this information and strive to develop an accurate estimation of the COD, however there are many circumstances that can arise during the development process that result in legitimate delays in project completion. Parties currently undertake every effort to identify a realistic COD at the time a PPA is signed – indeed, developers are legally obligated to ensure that representations contained in a PPA regarding the COD are made in good faith – as well as to keep the Commission apprised of any modification of the COD through mechanisms such as the semi-annual Project Development Status Report. The notion that parties will be able to foresee at the time the above-MPR PPA is submitted to the Commission for approval what obstacles will arise and will be more capable than they are today of providing a COD that satisfies the formal standard proposed in the Draft Resolution is unlikely to be borne out. Thus, it is not apparent what is to be gained from imposing this particular criterion. While developers should be encouraged to identify realistic CODs, imposing this requirement as part of a bright line test will merely render it impossible for the IOUs to satisfy the necessary criteria in order to obtain AMFs.

Similarly, the assumption that the IOU will, upon adoption of the criteria proposed in the Draft Resolution, be capable of *proving* that a resource is "viable" is unrealistic.[13/] Conclusions as to viability are derived from the processes currently approved for use in reviewing RFO bids; adoption of the proposed criterion will not confer upon the IOUs any greater ability to discern viability than they possess today. To the extent the IOUs would, in the event the proposed criteria were adopted, have at their disposal the same analytic tools that presently exist, it is not clear how they would satisfy the requirement that the viability of a particular resource be definitively established. Their inability to do so would create an insurmountable obstacle to accessing AMF funds. As with the accuracy of the COD, the question of project viability is an important one, but it is important for *all* contracts, not just for above-MPR contracts. The IOUs currently offer their best assessment of project viability based upon the analytic processes approved by the Commission, but this assessment is ultimately just that – a subjective assessment. The IOUs' ability to analyze project viability will not be altered or improved by adoption of a more rigorous review standard. The Commission's refusal to grant AMFs where the IOU is incapable of objectively proving project viability will simply result in fewer RPS PPAs being executed and will increase the IOUs' challenge in reaching 2010 RPS goals.

[12/] *See id*. at p. 20.
[13/] *See id*. at p. 21.

Additional shortcomings of the proposed review criteria include the reliance upon technology cost curves to be developed in the future as part of the Renewable Energy Transmission Initiate ("RETI").[14/] These technology cost curves are not currently in existence and it does not appear that they will be any time soon. This presents a practical problem for IOUs that intend to seek AMFs in the near or possibly even long term, since it is not known when these cost curves will be established. Moreover, it should be noted that such procedurally-developed cost estimates are unlikely to reflect changes in market conditions. In addition, the proposal in the Draft Resolution to condition AMF-eligibility of above-MPR PPA costs upon the related facility being physically located within California is overly-restrictive, given that the CEC's Eligibility Guidebook permits RPS contracts with out-of-state facilities to be deemed RPS-eligible where the first point of interconnection to the Western Electricity Coordinating Council ("WECC") is within California.[15]

SDG&E also objects to the proposal in the Draft Resolution to require the IOU's Independent Evaluator ("IE") to provide an assessment of the reasonableness of the PPA as well as the proposed project's financial model.[16/] Performing such an evaluation is not properly within the scope of the IE's responsibilities. The Commission established in D.06-05-039 the requirement that each IOU use an IE to "evaluate and report on the IOU's entire solicitation, evaluation and selection **process**."[17/] The purpose of this requirement, the Commission explained is to ensure "an open, fair and transparent **process** . . ."[18/] Thus, the analysis to be performed by the IE is limited to the process-related question of whether the IOU's solicitation and bid analysis was fairly conducted on the basis of the proper criteria. The IE's responsibilities do not include evaluating the reasonableness of particular contracts or related project financial models. Moreover, developers are not required to submit pro forma models as part of the competitive solicitation process and generally consider such models to be proprietary. Hence, this requirement is also unworkable from a practical perspective.

Although the ambiguities contained in the Draft Resolution make it impossible to fully address the non-ratemaking proposals concerning SB 1036 implementation, it is clear that many of the proposals contained in the Draft Resolution are defective and must not be adopted. Proposals regarding these more controversial aspects of SB 1036 implementation should be thoroughly examined in the context of workshops and comments. The ratemaking aspects of the Draft Resolution are non-controversial, however, and should be approved without further delay.

Best regards,

/s/ Aimee M. Smith
Aimee M. Smith

14/ *See id*. at p. 20.
15/ *See id*. at p. 18.
16/ *See* Draft Resolution at p. 20.
17/ D.06-05-039, *mimeo*, p. 45 (emphasis added).
18/ *Id*. (emphasis added).

Cc: President Peevey
Commissioner Grueneich
Commissioner Bohn
Commissioner Chong
Commissioner Simon
Lionel Wilson, CPUC General Counsel (Acting)
Angela Minkin, Chief Administrative Law Judge
ALJ Burton Mattson
ALJ Anne Simon
Sean Gallagher, Director, CPUC Energy Division
Cheryl Lee, CPUC Energy Division
Service List for Resolution E-4160 (R.06-02-012/R.06-05-027)

CERTIFICATE OF SERVICE

I hereby certify that a copy of **COMMENTS REGARDING DRAFT RESOLUTION E-4160** has been electronically mailed to each party of record on the service list in R.06-05-027 and R.06-02-012. Any party on the service list who has not provided an electronic mail address was served by placing copies in properly addressed and sealed envelopes and depositing such envelopes in the United States Mail with first-class postage prepaid.

Copies were also sent via Federal Express to the following individuals:

Commissioner Michael R. Peevey
Commissioner Dian Grueneich
Commissioner John Bohn
Commissioner Rachelle Chong
Commissioner Timothy Simon
Lionel Wilson, CPUC General Counsel (Acting)
Angela Minkin, Chief Administrative Law Judge
ALJ Burton Mattson
ALJ Anne Simon
Sean Gallagher, Director, CPUC Energy Division
Honesto Gatchalian

Executed this 1st day of April 2008 at San Diego, California

/s/ Jodi Ostrander
Jodi Ostrander